Accounting Standard (AS) 26
(issued 2002)

Intangible Assets

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APPENDICES

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*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the Preface to the Statements of Accounting Standards[1].)*

Accounting Standard (AS) 26, 'Intangible Assets', issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of expenditure incurred on intangible items during accounting periods commencing on or after 1-4-2003 and is mandatory in nature[2] from that date for the following:

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* It may be noted that the Institute has issued an Announcement in 2003 titled 'Applicability of Accounting Standard (AS) 26, Intangible Assets, to Intangible Items' (published in 'The Chartered Accountant', November 2003, pp. 479). The Announcement deals with the issue as to what should be the treatment of the expenditure incurred on intangible items, which were treated as deferred revenue expenditure and ordinarily spread over a period of 3 to 5 years before AS 26 became mandatory and which do not meet the definition of an 'asset' as per AS 26. The full text of the above Announcement has been reproduced in the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium.

It may also be noted that a limited revision to this Standard has been made in 2004, pursuant to which paragraph 1 of this Standard has been revised (see footnote 4). Pursuant to this limited revision, which comes into effect in respect of accounting periods commencing on or after 1-4-2003, the above Announcement stands superseded to the extent it deals with VRS expenditure, from the aforesaid date (see 'The Chartered Accountant', April 2004, pp.1157).

[1] Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

[2] Reference may be made to the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium for a detailed discussion on the implications of the mandatory status of an accounting standard.

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crores.

In respect of all other enterprises, the Accounting Standard comes into effect in respect of expenditure incurred on intangible items during accounting periods commencing on or after 1-4-2004 and is mandatory in nature from that date.

Earlier application of the Accounting Standard is encouraged.

In respect of intangible items appearing in the balance sheet as on the aforesaid date, i.e., 1-4-2003 or 1-4-2004, as the case may be, the Standard has limited application as stated in paragraph 99. From the date of this Standard becoming mandatory for the concerned enterprises, the following stand withdrawn:

(i) Accounting Standard (AS) 8, Accounting for Research and Development;

(ii) Accounting Standard (AS) 6, Depreciation Accounting, with respect to the amortisation (depreciation) of intangible assets; and

(iii) Accounting Standard (AS) 10, Accounting for Fixed Assets - paragraphs 16.3 to 16.7, 37 and 38.

The following is the text of the Accounting Standard.

Objective

The objective of this Statement is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard. This Statement requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. The Statement also specifies

how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets.

Scope

1. This Statement should be applied by all enterprises in accounting for intangible assets, except:

(a) intangible assets that are covered by another Accounting Standard;

(b) financial assets[3];

(c) mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources; and

(d) intangible assets arising in insurance enterprises from contracts with policyholders.

[4]This Statement should not be applied to expenditure in respect of termination benefits[5] also.

2. If another Accounting Standard deals with a specific type of intangible asset, an enterprise applies that Accounting Standard instead of this Statement. For example, this Statement does not apply to:

[3] A financial asset is any asset that is:
(a) cash;
(b) a contractual right to receive cash or another financial asset from another enterprise;
(c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or
(d) an ownership interest in another enterprise.

[4] The Council of the Institute decided to make a limited revision to AS 26 in 2004, pursuant to which the last sentence has been added to paragraph 1. This revision comes into effect in respect of accounting periods commencing on or after 1.4.2003 (see 'The Chartered Accountant', April 2004, pp. 1157).

[5] Accounting Standard (AS) 15 (revised 2005), *Employee Benefits*, which comes into effect in respect of accounting periods commencing on or after 1-4-2006, specifies the requirements relating to accounting for 'Termination Benefits'.

(a) intangible assets held by an enterprise for sale in the ordinary course of business (see AS 2, Valuation of Inventories, and AS 7, Accounting for Construction Contracts[6]);

(b) deferred tax assets (see AS 22, Accounting for Taxes on Income);

(c) leases that fall within the scope of AS 19, Leases; and

(d) goodwill arising on an amalgamation (see AS 14, Accounting for Amalgamations) and goodwill arising on consolidation (see AS 21, Consolidated Financial Statements).

3. This Statement applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (for example, a prototype), the physical element of the asset is secondary to its intangible component, that is the knowledge embodied in it. This Statement also applies to rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights. These items are excluded from the scope of AS 19.

4. In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee deals with an intangible asset held under a finance lease under this Statement.

5. Exclusions from the scope of an Accounting Standard may occur if certain activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of contracts between insurance enterprises and their policyholders. Therefore, this Statement does not apply to expenditure on such activities. However, this Statement applies to other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance enterprises. Accounting issues of specialised nature also arise in respect of accounting for discount or premium

[6] This Standard has been revised and titled as 'Construction Contracts'. The revised AS 7 is published elsewhere in this Compendium.

relating to borrowings and ancillary costs incurred in connection with the arrangement of borrowings, share issue expenses and discount allowed on the issue of shares. Accordingly, this Statement does not apply to such items also.

Definitions

6. The following terms are used in this Statement with the meanings specified:

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

An asset is a resource:

(a) controlled by an enterprise as a result of past events; and

(b) from which future economic benefits are expected to flow to the enterprise.

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

Non-monetary assets are assets other than monetary assets.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

Depreciable amount is the cost of an asset less its residual value.

Useful life ***is either:***

(a) the period of time over which an asset is expected to be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the asset by the enterprise.

Residual value ***is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.***

Fair value ***of an asset is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.***

An active market is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.[7]

Carrying amount ***is the amount at which an asset is recognised in the balance sheet, net of any accumulated amortisation and accumulated impairment losses thereon.***

Intangible Assets

7. Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property,

[7] Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights. Goodwill is another example of an item of intangible nature which either arises on acquisition or is internally generated.

8. Not all the items described in paragraph 7 will meet the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise. If an item covered by this Statement does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of the goodwill recognised at the date of the amalgamation (see paragraph 55).

9. Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of a licence or patent) or film (in the case of motion pictures). The cost of the physical substance containing the intangible assets is usually not significant. Accordingly, the physical substance containing an intangible asset, though tangible in nature, is commonly treated as a part of the intangible asset contained in or on it.

10. In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. In determining whether such an asset should be treated under AS 10, Accounting for Fixed Assets, or as an intangible asset under this Statement, judgement is required to assess as to which element is predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

Identifiability

11. The definition of an intangible asset requires that an intangible asset be identifiable. To be identifiable, it is necessary that the intangible asset is clearly distinguished from goodwill. Goodwill arising on an amalgamation in

the nature of purchase represents a payment made by the acquirer in anticipation of future economic benefits. The future economic benefits may result from synergy between the identifiable assets acquired or from assets which, individually, do not qualify for recognition in the financial statements but for which the acquirer is prepared to make a payment in the amalgamation.

12. An intangible asset can be clearly distinguished from goodwill if the asset is separable. An asset is separable if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity.

13. Separability is not a necessary condition for identifiability since an enterprise may be able to identify an asset in some other way. For example, if an intangible asset is acquired with a group of assets, the transaction may involve the transfer of legal rights that enable an enterprise to identify the intangible asset. Similarly, if an internal project aims to create legal rights for the enterprise, the nature of these rights may assist the enterprise in identifying an underlying internally generated intangible asset. Also, even if an asset generates future economic benefits only in combination with other assets, the asset is identifiable if the enterprise can identify the future economic benefits that will flow from the asset.

Control

14. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way.

15. Market and technical knowledge may give rise to future economic benefits. An enterprise controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.

16. An enterprise may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The enterprise may also expect that the staff will continue to make their skills available to the enterprise. However, usually an enterprise has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training to consider that these items meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

17. An enterprise may have a portfolio of customers or a market share and expect that, due to its efforts in building customer relationships and loyalty, the customers will continue to trade with the enterprise. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the enterprise, the enterprise usually has insufficient control over the economic benefits from customer relationships and loyalty to consider that such items (portfolio of customers, market shares, customer relationships, customer loyalty) meet the definition of intangible assets.

Future Economic Benefits

18. The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the enterprise. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

Recognition and Initial Measurement of an Intangible Asset

19. The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the:

(a) definition of an intangible asset (see paragraphs 6-18); and

(b) recognition criteria set out in this Statement (see paragraphs 20-54).

20. An intangible asset should be recognised if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

(b) the cost of the asset can be measured reliably.

21. An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.

22. An enterprise uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.

23. An intangible asset should be measured initially at cost.

Separate Acquisition

24. If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

25. The cost of an intangible asset comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and any directly attributable expenditure on making the asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services. Any trade discounts and rebates are deducted in arriving at the cost.

26. If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.

Acquisition as Part of an Amalgamation

27. An intangible asset acquired in an amalgamation in the nature of purchase is accounted for in accordance with Accounting Standard (AS) 14,

Accounting for Amalgamations. Where in preparing the financial statements of the transferee company, the consideration is allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation, paragraphs 28 to 32 of this Statement need to be considered.

28. Judgement is required to determine whether the cost (i.e. fair value) of an intangible asset acquired in an amalgamation can be measured with sufficient reliability for the purpose of separate recognition. Quoted market prices in an active market provide the most reliable measurement of fair value. The appropriate market price is usually the current bid price. If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.

29. If no active market exists for an asset, its cost reflects the amount that the enterprise would have paid, at the date of the acquisition, for the asset in an arm's length transaction between knowledgeable and willing parties, based on the best information available. In determining this amount, an enterprise considers the outcome of recent transactions for similar assets.

30. Certain enterprises that are regularly involved in the purchase and sale of unique intangible assets have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in an amalgamation in the nature of purchase if their objective is to estimate fair value as defined in this Statement and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, where appropriate, applying multiples reflecting current market transactions to certain indicators driving the profitability of the asset (such as revenue, market shares, operating profit, etc.) or discounting estimated future net cash flows from the asset.

31. In accordance with this Statement:

(a) a transferee recognises an intangible asset that meets the recognition criteria in paragraphs 20 and 21, even if that intangible asset had not been recognised in the financial statements of the transferor; and

(b) if the cost (i.e. fair value) of an intangible asset acquired as part

of an amalgamation in the nature of purchase cannot be measured reliably, that asset is not recognised as a separate intangible asset but is included in goodwill (see paragraph 55).

32. Unless there is an active market for an intangible asset acquired in an amalgamation in the nature of purchase, the cost initially recognised for the intangible asset is restricted to an amount that does not create or increase any capital reserve arising at the date of the amalgamation.

Acquisition by way of a Government Grant

33. In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may occur when a government transfers or allocates to an enterprise intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. AS 12, Accounting for Government Grants, requires that government grants in the form of non-monetary assets, given at a concessional rate should be accounted for on the basis of their acquisition cost. AS 12 also requires that in case a non-monetary asset is given free of cost, it should be recorded at a nominal value. Accordingly, intangible asset acquired free of charge, or for nominal consideration, by way of government grant is recognised at a nominal value or at the acquisition cost, as appropriate; any expenditure that is directly attributable to making the asset ready for its intended use is also included in the cost of the asset.

Exchanges of Assets

34. An intangible asset may be acquired in exchange or part exchange for another asset. In such a case, the cost of the asset acquired is determined in accordance with the principles laid down in this regard in AS 10, Accounting for Fixed Assets.

Internally Generated Goodwill

35. Internally generated goodwill should not be recognised as an asset.

36. In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets

the recognition criteria in this Statement. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

37. Differences between the market value of an enterprise and the carrying amount of its identifiable net assets at any point in time may be due to a range of factors that affect the value of the enterprise. However, such differences cannot be considered to represent the cost of intangible assets controlled by the enterprise.

Internally Generated Intangible Assets

38. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition. It is often difficult to:

(a) identify whether, and the point of time when, there is an identifiable asset that will generate probable future economic benefits; and

(b) determine the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the enterprise's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an enterprise applies the requirements and guidance in paragraphs 39-54 below to all internally generated intangible assets.

39. To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into:

(a) a research phase; and

(b) a development phase.

Although the terms 'research' and 'development' are defined, the terms 'research phase' and 'development phase' have a broader meaning for the purpose of this Statement.

40. If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

Research Phase

41. No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.

42. This Statement takes the view that, in the research phase of a project, an enterprise cannot demonstrate that an intangible asset exists from which future economic benefits are probable. Therefore, this expenditure is recognised as an expense when it is incurred.

43. Examples of research activities are:

(a) activities aimed at obtaining new knowledge;

(b) the search for, evaluation and final selection of, applications of research findings or other knowledge;

(c) the search for alternatives for materials, devices, products, processes, systems or services; and

(d) the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development Phase

44. An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

45. In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

46. Examples of development activities are:

(a) the design, construction and testing of pre-production or pre-use prototypes and models;

(b) the design of tools, jigs, moulds and dies involving new technology;

(c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and

(d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

47. To demonstrate how an intangible asset will generate probable future economic benefits, an enterprise assesses the future economic benefits to be received from the asset using the principles in Accounting Standard on Impairment of Assets[8]. If the asset will generate economic benefits only in

[8] Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

combination with other assets, the enterprise applies the concept of cash-generating units as set out in Accounting Standard on Impairment of Assets.

48. Availability of resources to complete, use and obtain the benefits from an intangible asset can be demonstrated by, for example, a business plan showing the technical, financial and other resources needed and the enterprise's ability to secure those resources. In certain cases, an enterprise demonstrates the availability of external finance by obtaining a lender's indication of its willingness to fund the plan.

49. An enterprise's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing copyrights or licences or developing computer software.

50. Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets.

51. This Statement takes the view that expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Cost of an Internally Generated Intangible Asset

52. The cost of an internally generated intangible asset for the purpose of paragraph 23 is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria in paragraphs 20-21 and 44. Paragraph 58 prohibits reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports.

53. The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use. The cost includes, if applicable:

(a) expenditure on materials and services used or consumed in generating the intangible asset;

(b) the salaries, wages and other employment related costs of personnel directly engaged in generating the asset;

(c) any expenditure that is directly attributable to generating the asset, such as fees to register a legal right and the amortisation of patents and licences that are used to generate the asset; and

(d) overheads that are necessary to generate the asset and that can be allocated on a reasonable and consistent basis to the asset (for example, an allocation of the depreciation of fixed assets, insurance premium and rent). Allocations of overheads are made on bases similar to those used in allocating overheads to inventories (see AS 2, Valuation of Inventories). AS 16, Borrowing Costs, establishes criteria for the recognition of interest as a component of the cost of a qualifying asset. These criteria are also applied for the recognition of interest as a component of the cost of an internally generated intangible asset.

54. The following are not components of the cost of an internally generated intangible asset:

(a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use;

(b) clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance; and

(c) expenditure on training the staff to operate the asset.

Example Illustrating Paragraph 52

An enterprise is developing a new production process. During the year 20X1, expenditure incurred was Rs. 10 lakhs, of which Rs. 9 lakhs was incurred before 1 December 20X1 and 1 lakh was incurred between 1 December 20X1 and 31 December 20X1. The enterprise is able to demonstrate that, at 1 December 20X1, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process
(including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 5 lakhs.

At the end of 20X1, the production process is recognised as an intangible asset at a cost of Rs. 1 lakh (expenditure incurred since the

date when the recognition criteria were met, that is, 1 December 20X1). The Rs. 9 lakhs expenditure incurred before 1 December 20X1 is recognised as an expense because the recognition criteria were not met until 1 December 20X1. This expenditure will never form part of the cost of the production process recognised in the balance sheet.

During the year 20X2, expenditure incurred is Rs. 20 lakhs. At the end of 20X2, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 19 lakhs.

At the end of the year 20X2, the cost of the production process is Rs. 21 lakhs (Rs. 1 lakh expenditure recognised at the end of 20X1 plus Rs. 20 lakhs expenditure recognised in 20X2). The enterprise recognises an impairment loss of Rs. 2 lakhs to adjust the carrying amount of the process before impairment loss (Rs. 21 lakhs) to its recoverable amount (Rs. 19 lakhs). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in Accounting Standard on Impairment of Assets[9], are met.

Recognition of an Expense

55. Expenditure on an intangible item should be recognised as an expense when it is incurred unless:

(a) it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 19-54); or

(b) the item is acquired in an amalgamation in the nature of purchase and cannot be recognised as an intangible asset. If this is the case, this expenditure (included in the cost of acquisition) should form part of the amount attributed to goodwill (capital reserve) at the date of acquisition (see AS 14, Accounting for Amalgamations).

56. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is

[9] Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

recognised as an expense when it is incurred. For example, expenditure on research is always recognised as an expense when it is incurred (see paragraph 41). Examples of other expenditure that is recognised as an expense when it is incurred include:

(a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);

(b) expenditure on training activities;

(c) expenditure on advertising and promotional activities; and

(d) expenditure on relocating or re-organising part or all of an enterprise.

57. Paragraph 55 does not apply to payments for the delivery of goods or services made in advance of the delivery of goods or the rendering of services. Such prepayments are recognised as assets.

Past Expenses not to be Recognised as an Asset

58. Expenditure on an intangible item that was initially recognised as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognised as part of the cost of an intangible asset at a later date.

Subsequent Expenditure

59. Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless:

(a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and

(b) the expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

60. Subsequent expenditure on a recognised intangible asset is recognised as an expense if this expenditure is required to maintain the asset at its originally assessed standard of performance. The nature of intangible assets is such that, in many cases, it is not possible to determine whether subsequent expenditure is likely to enhance or maintain the economic benefits that will flow to the enterprise from those assets. In addition, it is often difficult to attribute such expenditure directly to a particular intangible asset rather than the business as a whole. Therefore, only rarely will expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset result in additions to the cost of the intangible asset.

61. Consistent with paragraph 50, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally purchased or internally generated) is always recognised as an expense to avoid the recognition of internally generated goodwill.

Measurement Subsequent to Initial Recognition

62. After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Amortisation

Amortisation Period

63. The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

64. As the future economic benefits embodied in an intangible asset are

consumed over time, the carrying amount of the asset is reduced to reflect that consumption. This is achieved by systematic allocation of the cost of the asset, less any residual value, as an expense over the asset's useful life. Amortisation is recognised whether or not there has been an increase in, for example, the asset's fair value or recoverable amount. Many factors need to be considered in determining the useful life of an intangible asset including:

(a) the expected usage of the asset by the enterprise and whether the asset could be efficiently managed by another management team;

(b) typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets that are used in a similar way;

(c) technical, technological or other types of obsolescence;

(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) expected actions by competitors or potential competitors;

(f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the company's ability and intent to reach such a level;

(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) whether the useful life of the asset is dependent on the useful life of other assets of the enterprise.

65. Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life will be short.

66. Estimates of the useful life of an intangible asset generally become less reliable as the length of the useful life increases. This Statement adopts a presumption that the useful life of intangible assets is unlikely to exceed ten years.

67. In some cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than ten years. In these cases, the presumption that the useful life generally does not exceed ten years is rebutted and the enterprise:

(a) amortises the intangible asset over the best estimate of its useful life;

(b) estimates the recoverable amount of the intangible asset at least annually in order to identify any impairment loss (see paragraph 83); and

(c) discloses the reasons why the presumption is rebutted and the factor(s) that played a significant role in determining the useful life of the asset (see paragraph 94(a)).

Examples

A. An enterprise has purchased an exclusive right to generate hydro-electric power for sixty years. The costs of generating hydro-electric power are much lower than the costs of obtaining power from alternative sources. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least sixty years.

The enterprise amortises the right to generate power over sixty years, unless there is evidence that its useful life is shorter.

B. An enterprise has purchased an exclusive right to operate a toll motorway for thirty years. There is no plan to construct alternative routes in the area served by the motorway. It is expected that this motorway will be in use for at least thirty years.

The enterprise amortises the right to operate the motorway over thirty years, unless there is evidence that its useful life is shorter.

68. The useful life of an intangible asset may be very long but it is always finite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.

69. If control over the future economic benefits from an intangible

asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:

(a) the legal rights are renewable; and

(b) renewal is virtually certain.

70. There may be both economic and legal factors influencing the useful life of an intangible asset: economic factors determine the period over which future economic benefits will be generated; legal factors may restrict the period over which the enterprise controls access to these benefits. The useful life is the shorter of the periods determined by these factors.

71. The following factors, among others, indicate that renewal of a legal right is virtually certain:

(a) the fair value of the intangible asset is not expected to reduce as the initial expiry date approaches, or is not expected to reduce by more than the cost of renewing the underlying right;

(b) there is evidence (possibly based on past experience) that the legal rights will be renewed; and

(c) there is evidence that the conditions necessary to obtain the renewal of the legal right (if any) will be satisfied.

Amortisation Method

72. The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expense unless another Accounting Standard permits or requires
it to be included in the carrying amount of another asset.

73. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the unit of production method. The method used for an asset is selected based on the expected pattern of consumption of economic benefits

and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset. There will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method.

74. Amortisation is usually recognised as an expense. However, sometimes, the economic benefits embodied in an asset are absorbed by the enterprise in producing other assets rather than giving rise to an expense. In these cases, the amortisation charge forms part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see AS 2, Valuation of Inventories).

Residual Value

75. The residual value of an intangible asset should be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

76. A residual value other than zero implies that an enterprise expects to dispose of the intangible asset before the end of its economic life.

77. The residual value is estimated using prices prevailing at the date of acquisition of the asset, for the sale of a similar asset that has reached the end of its estimated useful life and that has operated under conditions similar to those in which the asset will be used. The residual value is not subsequently increased for changes in prices or value.

Review of Amortisation Period and Amortisation Method

78. The amortisation period and the amortisation method should be reviewed at least at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

79. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure that improves the condition of the asset beyond its originally assessed standard of performance. Also, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.

80. Over time, the pattern of future economic benefits expected to flow to an enterprise from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortisation is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the business plan. In this case, economic benefits that flow from the asset may not be received until later periods.

Recoverability of the Carrying Amount—Impairment Losses

81. To determine whether an intangible asset is impaired, an enterprise applies Accounting Standard on Impairment of Assets[10]. That Standard explains how an enterprise reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.

[10] Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

82. If an impairment loss occurs before the end of the first annual accounting period commencing after acquisition for an intangible asset acquired in an amalgamation in the nature of purchase, the impairment loss is recognised as an adjustment to both the amount assigned to the intangible asset and the goodwill (capital reserve) recognised at the date of the amalgamation. However, if the impairment loss relates to specific events or changes in circumstances occurring after the date of acquisition, the impairment loss is recognised under Accounting Standard on Impairment of Assets and not as an adjustment to the amount assigned to the goodwill (capital reserve) recognised at the date of acquisition.

83. In addition to the requirements of Accounting Standard on Impairment of Assets, an enterprise should estimate the recoverable amount of the following intangible assets at least at each financial year end even if there is no indication that the asset is impaired:

(a) an intangible asset that is not yet available for use; and

(b) an intangible asset that is amortised over a period exceeding ten years from the date when the asset is available for use.

The recoverable amount should be determined under Accounting Standard on Impairment of Assets and impairment losses recognised accordingly.

84. The ability of an intangible asset to generate sufficient future economic benefits to recover its cost is usually subject to great uncertainty until the asset is available for use. Therefore, this Statement requires an enterprise to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

85. It is sometimes difficult to identify whether an intangible asset may be impaired because, among other things, there is not necessarily any obvious evidence of obsolescence. This difficulty arises particularly if the asset has a long useful life. As a consequence, this Statement requires, as a minimum, an annual calculation of the recoverable amount of an intangible asset if its useful life exceeds ten years from the date when it becomes available for use.

86. The requirement for an annual impairment test of an intangible asset applies whenever the current total estimated useful life of the asset exceeds ten years from when it became available for use. Therefore, if the useful

life of an intangible asset was estimated to be less than ten years at initial recognition, but the useful life is extended by subsequent expenditure to exceed ten years from when the asset became available for use, an enterprise performs the impairment test required under paragraph 83(b) and also makes the disclosure required under paragraph 94(a).

Retirements and Disposals

87. An intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

88. Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

89. An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets[11], and recognises any impairment loss accordingly.

Disclosure

General

90. The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

(a) the useful lives or the amortisation rates used;

(b) the amortisation methods used;

(c) the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;

[11] Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

(d) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions, indicating separately those from internal development and through amalgamation;

(ii) retirements and disposals;

(iii) impairment losses recognised in the statement of profit and loss during the period (if any);

(iv) impairment losses reversed in the statement of profit and loss during the period (if any);

(v) amortisation recognised during the period; and

(vi) other changes in the carrying amount during the period.

91. A class of intangible assets is a grouping of assets of a similar nature and use in an enterprise's operations. Examples of separate classes may include:

(a) brand names;

(b) mastheads and publishing titles;

(c) computer software;

(d) licences and franchises;

(e) copyrights, and patents and other industrial property rights, service and operating rights;

(f) recipes, formulae, models, designs and prototypes; and

(g) intangible assets under development.

The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.

92. An enterprise discloses information on impaired intangible assets under

Accounting Standard on Impairment of Assets[12] in addition to the information required by paragraph 90(d)(iii) and (iv).

93. An enterprise discloses the change in an accounting estimate or accounting policy such as that arising from changes in the amortisation method, the amortisation period or estimated residual values, in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

94. The financial statements should also disclose:

(a) if an intangible asset is amortised over more than ten years, the reasons why it is presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the asset;

(b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the enterprise as a whole;

(c) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities; and

(d) the amount of commitments for the acquisition of intangible assets.

95. When an enterprise describes the factor(s) that played a significant role in determining the useful life of an intangible asset that is amortised over more than ten years, the enterprise considers the list of factors in paragraph 64.

Research and Development Expenditure

96. The financial statements should disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

[12] Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

97. Research and development expenditure comprises all expenditure that is directly attributable to research or development activities or that can be allocated on a reasonable and consistent basis to such activities (see paragraphs 53-54 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 96).

Other Information

98. An enterprise is encouraged, but not required, to give a description of any fully amortised intangible asset that is still in use.

Transitional Provisions

99. Where, on the date of this Statement coming into effect, an enterprise is following an accounting policy of not amortising an intangible item or amortising an intangible item over a period longer than the period determined under paragraph 63 of this Statement and the period determined under paragraph 63 has expired on the date of this Statement coming into effect, the carrying amount appearing in the balance sheet in respect of that item should be eliminated with a corresponding adjustment to the opening balance of revenue reserves.

In the event the period determined under paragraph 63 has not expired on the date of this Statement coming into effect and:

(a) if the enterprise is following an accounting policy of not amortising an intangible item, the carrying amount of the intangible item should be restated, as if the accumulated amortisation had always been determined under this Statement, with the corresponding adjustment to the opening balance of revenue reserves. The restated carrying amount should be amortised over the balance of the period as determined in paragraph 63.

(b) if the remaining period as per the accounting policy followed by the enterprise:

(i) is shorter as compared to the balance of the period determined under paragraph 63, the carrying amount of the intangible item should be amortised over the

remaining period as per the accounting policy followed by the enterprise,

(ii) is longer as compared to the balance of the period determined under paragraph 63, the carrying amount of the intangible item should be restated, as if the accumulated amortisation had always been determined under this Statement, with the corresponding adjustment to the opening balance of revenue reserves. The restated carrying amount should be amortised over the balance of the period as determined in paragraph 63.[13]

100. Appendix B illustrates the application of paragraph 99.

[13] See also footnote marked '*' on page 503.

Appendix A

This Appendix, which is illustrative and does not form part of the Accounting Standard, provides illustrative application of the principles laid down in the Standard to internal use software and web-site costs. The purpose of the appendix is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

I. Illustrative Application of the Accounting Standard to Internal Use Computer Software

Computer software for internal use can be internally generated or acquired.

Internally Generated Computer Software

1. Internally generated computer software for internal use is developed or modified internally by the enterprise solely to meet the needs of the enterprise and at no stage it is planned to sell it.

2. The stages of development of internally generated software may be categorised into the following two phases:

- Preliminary project stage, i.e., the research phase
- Development stage

Preliminary project stage

3. At the preliminary project stage the internally generated software should not be recognised as an asset. Expenditure incurred in the preliminary project stage should be recognised as an expense when it is incurred. The reason for such a treatment is that at this stage of the software project an enterprise can not demonstrate that an asset exists from which future economic benefits are probable.

4. When a computer software project is in the preliminary project stage, enterprises are likely to:

(a) Make strategic decisions to allocate resources between alternative projects at a given point in time. For example, should programmers

develop a new payroll system or direct their efforts toward correcting existing problems in an operating payroll system.

(b) Determine the performance requirements (that is, what it is that they need the software to do) and systems requirements for the computer software project it has proposed to undertake.

(c) Explore alternative means of achieving specified performance requirements. For example, should an entity make or buy the software. Should the software run on a mainframe or a client server system.

(d) Determine that the technology needed to achieve performance requirements exists.

(e) Select a consultant to assist in the development and/or installation of the software.

Development Stage

5. An internally generated software arising at the development stage should be recognised as an asset if, and only if, an enterprise can demonstrate all of the following:

(a) the technical feasibility of completing the internally generated software so that it will be available for internal use;

(b) the intention of the enterprise to complete the internally generated software and use it to perform the functions intended. For example, the intention to complete the internally generated software can be demonstrated if the enterprise commits to the funding of the software project;

(c) the ability of the enterprise to use the software;

(d) how the software will generate probable future economic benefits. Among other things, the enterprise should demonstrate the usefulness of the software;

(e) the availability of adequate technical, financial and other resources to complete the development and to use the software; and

(f) the ability of the enterprise to measure the expenditure attributable to the software during its development reliably.

6. Examples of development activities in respect of internally generated software include:

(a) Design including detailed program design - which is the process of detail design of computer software that takes product function, feature, and technical requirements to their most detailed, logical form and is ready for coding.

(b) Coding which includes generating detailed instructions in a computer language to carry out the requirements described in the detail program design. The coding of computer software may begin prior to, concurrent with, or subsequent to the completion of the detail program design.

At the end of these stages of the development activity, the enterprise has a working model, which is an operative version of the computer software capable of performing all the major planned functions, and is ready for initial testing ("beta" versions).

(c) Testing which is the process of performing the steps necessary to determine whether the coded computer software product meets function, feature, and technical performance requirements set forth in the product design.

At the end of the testing process, the enterprise has a master version of the internal use software, which is a completed version together with the related user documentation and the training materials.

Cost of internally generated software

7. The cost of an internally generated software is the sum of the expenditure incurred from the time when the software first met the recognition criteria for an intangible asset as stated in paragraphs 20 and 21 of this Statement and paragraph 5 above. An expenditure which did not meet the recognition criteria as aforesaid and expensed in an earlier financial statements should not be reinstated if the recognition criteria are met later.

8. The cost of an internally generated software comprises all expenditure that can be directly attributed or allocated on a reasonable and consistent basis to create the software for its intended use. The cost include:

(a) expenditure on materials and services used or consumed in developing the software;

(b) the salaries, wages and other employment related costs of personnel directly engaged in developing the software;

(c) any expenditure that is directly attributable to generating software; and

(d) overheads that are necessary to generate the software and that can be allocated on a reasonable and consistent basis to the software (For example, an allocation of the depreciation of fixed assets, insurance premium and rent). Allocation of overheads are made on basis similar to those used in allocating the overhead to inventories.

9. The following are not components of the cost of an internally generated software:

(a) selling, administration and other general overhead expenditure unless this expenditure can be directly attributable to the development of the software;

(b) clearly identified inefficiencies and initial operating losses incurred before software achieves the planned performance; and

(c) expenditure on training the staff to use the internally generated software.

Software Acquired for Internal Use

10. The cost of a software acquired for internal use should be recognised as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of this Statement.

11. The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those

subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use. Any trade discounts and rebates are deducted in arriving at the cost. In the determination of cost, matters stated in paragraphs 24 to 34 of the Statement need to be considered, as appropriate.

Subsequent expenditure

12. Enterprises may incur considerable cost in modifying existing software systems. Subsequent expenditure on software after its purchase or its completion should be recognised as an expense when it is incurred unless:

(a) it is probable that the expenditure will enable the software to generate future economic benefits in excess of its originally assessed standards of performance; and

(b) the expenditure can be measured and attributed to the software reliably.

If these conditions are met, the subsequent expenditure should be added to the carrying amount of the software. Costs incurred in order to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of existing software systems is recognised as an expense when, and only when, the restoration or maintenance work is carried out.

Amortisation period

13. The depreciable amount of a software should be allocated on a systematic basis over the best estimate of its useful life. The amortisation should commence when the software is available for use.

14. As per this Statement, there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. However, given the history of rapid changes in technology, computer software is susceptible to technological obsolescence. Therefore, it is likely that useful life of the software will be much shorter, say 3 to 5 years.

Amortisation method

15. The amortisation method used should reflect the pattern in which the software's economic benefits are consumed by the enterprise. If that pattern can not be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expenditure unless another Accounting Standard permits or requires it to be included in the carrying amount of another asset. For example, the amortisation of a software used in a production process is included in the carrying amount of inventories.

II. Illustrative Application of the Accounting Standard to Web-Site Costs

1. An enterprise may incur internal expenditures when developing, enhancing and maintaining its own web site. The web site may be used for various purposes such as promoting and advertising products and services, providing electronic services, and selling products and services.

2. The stages of a web site's development can be described as follows:

(a) Planning - includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences;

(b) Application and Infrastructure Development - includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing; and

(c) Graphical Design and Content Development - includes designing the appearance of web pages and creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site prior to the web site becoming available for use. This information may either be stored in separate databases that are integrated into (or accessed from) the web site or coded directly into the web pages.

3. Once development of a web site has been completed and the web site is available for use, the web site commences an operating stage. During this

stage, an enterprise maintains and enhances the applications, infrastructure, graphical design and content of the web site.

4. The expenditures for purchasing, developing, maintaining and enhancing hardware (e.g., web servers, staging servers, production servers and Internet connections) related to a web site are not accounted for under this Statement but are accounted for under AS 10, Accounting for Fixed Assets. Additionally, when an enterprise incurs an expenditure for having an Internet service provider host the enterprise's web site on it's own servers connected to the Internet, the expenditure is recognised as an expense.

5. An intangible asset is defined in paragraph 6 of this Statement as an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Paragraph 7 of this Statement provides computer software as a common example of an intangible asset. By analogy, a web site is another example of an intangible asset. Accordingly, a web site developed by an enterprise for its own use is an internally generated intangible asset that is subject to the requirements of this Statement.

6. An enterprise should apply the requirements of this Statement to an internal expenditure for developing, enhancing and maintaining its own web site. Paragraph 55 of this Statement provides expenditure on an intangible item to be recognised as an expense when incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria in paragraphs 19-54 of the Statement. Paragraph 56 of the Statement requires expenditure on start-up activities to be recognised as an expense when incurred. Developing a web site by an enterprise for its own use is not a start-up activity to the extent that an internally generated intangible asset is created. An enterprise applies the requirements and guidance in paragraphs 39-54 of this Statement to an expenditure incurred for developing its own web site in addition to the general requirements for recognition and initial measurement of an intangible asset. The cost of a web site, as described in paragraphs 52-54 of this Statement, comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and preparing the asset for its intended use.

The enterprise should evaluate the nature of each activity for which an expenditure is incurred (e.g., training employees and maintaining the web site) and the web site's stage of development or post-development:

(a) Paragraph 41 of this Statement requires an expenditure on research (or on the research phase of an internal project) to be recognised as an expense when incurred. The examples provided in paragraph 43 of this Statement are similar to the activities undertaken in the Planning stage of a web site's development. Consequently, expenditures incurred in the Planning stage of a web site's development are recognised as an expense when incurred.

(b) Paragraph 44 of this Statement requires an intangible asset arising from the development phase of an internal project to be recognised if an enterprise can demonstrate fulfillment of the six criteria specified. Application and Infrastructure Development and Graphical Design and Content Development stages are similar in nature to the development phase. Therefore, expenditures incurred in these stages should be recognised as an intangible asset if, and only if, in addition to complying with the general requirements for recognition and initial measurement of an intangible asset, an enterprise can demonstrate those items described in paragraph 44 of this Statement. In addition,

(i) an enterprise may be able to demonstrate how its web site will generate probable future economic benefits under paragraph 44(d) by using the principles in Accounting Standard on Impairment of Assets[14]. This includes situations where the web site is developed solely or primarily for promoting and advertising an enterprise's own products and services. Demonstrating how a web site will generate probable future economic benefits under paragraph 44(d) by assessing the economic benefits to be received from the web site and using the principles in Accounting Standard on Impairment of Assets, may be particularly difficult for an enterprise that develops a web site solely or primarily for advertising and promoting its own products and services; information is unlikely to be available for reliably estimating the amount obtainable from the sale of the web site in an arm's length transaction, or the future cash inflows and outflows to be derived from its

[14] Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

continuing use and ultimate disposal. In this circumstance, an enterprise determines the future economic benefits of the cash-generating unit to which the web site belongs, if it does not belong to one. If the web site is considered a corporate asset (one that does not generate cash inflows independently from other assets and their carrying amount cannot be fully attributed to a cash-generating unit), then an enterprise applies the 'bottom-up' test and/or the 'top-down' test under Accounting Standard on Impairment of Assets.

(ii) an enterprise may incur an expenditure to enable use of content, which had been purchased or created for another purpose, on its web site (e.g., acquiring a license to reproduce information) or may purchase or create content specifically for use on its web site prior to the web site becoming available for use. In such circumstances, an enterprise should determine whether a separate asset, is identifiable with respect to such content (e.g., copyrights and licenses), and if a separate asset is not identifiable, then the expenditure should be included in the cost of developing the web site when the expenditure meets the conditions in paragraph 44 of this Statement. As per paragraph 20 of this Statement, an intangible asset is recognised if, and only if, it meets specified criteria, including the definition of an intangible asset. Paragraph 52 indicates that the cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the specified recognition criteria. When an enterprise acquires or creates content, it may be possible to identify an intangible asset (e.g., a license or a copyright) separate from a web site. Consequently, an enterprise determines whether an expenditure to enable use of content, which had been created for another purpose, on its web site becoming available for use results in a separate identifiable asset or the expenditure is included in the cost of developing the web site.

(c) the operating stage commences once the web site is available for use, and therefore an expenditure to maintain or enhance the web site after development has been completed should be recognised as an expense when it is incurred unless it meets the

criteria in paragraph 59 of the Statement. Paragraph 60 explains that if the expenditure is required to maintain the asset at its originally assessed standard of performance, then the expenditure is recognised as an expense when incurred.

7. An intangible asset is measured subsequent to initial recognition by applying the requirements in paragraph 62 of this Statement. Additionally, since paragraph 68 of the Statement states that an intangible asset always has a finite useful life, a web site that is recognised as an asset is amortised over the best estimate of its useful life. As indicated in paragraph 65 of the Statement, web sites are susceptible to technological obsolescence, and given the history of rapid changes in technology, their useful life will be short.

8. The following table illustrates examples of expenditures that occur within each of the stages described in paragraphs 2 and 3 above and application of paragraphs 5 and 6 above. It is not intended to be a comprehensive checklist of expenditures that might be incurred.

Nature of Expenditure	**Accounting treatment**
Planning • undertaking feasibility studies • defining hardware and software specifications • evaluating alternative products and suppliers • selecting preferences	Expense when incurred
Application and Infrastructure Development • purchasing or developing hardware	Apply the requirements of AS 10
• obtaining a domain name • developing operating software (e.g., operating system and server software) • developing code for the application • installing developed applications on the web server • stress testing	Expense when incurred, unless it meets the recognition criteria under paragraphs 20 and 44

Graphical Design and Content Development • designing the appearance (e.g., layout and colour) of web pages • creating, purchasing, preparing (e.g., creating links and identifying tags), and uploading information, either textual or graphical in nature, on the web site prior to the web site becoming available for use. Examples of content include information about an enterprise, products or services offered for sale, and topics that subscribers access	If a separate asset is not identifiable, then expense when incurred, unless it meets the recognition criteria under paragraphs 20 and 44
Operating • updating graphics and revising content • adding new functions, features and content • registering the web site with search engines • backing up data • reviewing security access • analysing usage of the web site	Expense when incurred, unless in rare circumstances it meets the criteria in paragraph 59, in which case the expenditure is included in the cost of the web site
Other • selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use • clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance (e.g., false start testing) • training employees to operate the web site	Expense when incurred

Appendix B

This Appendix, which is illustrative and does not form part of the Accounting Standard, provides illustrative application of the requirements contained in paragraph 99 of this Accounting Standard in respect of transitional provisions.

Example 1 - Intangible Item was not amortised and the amortisation period determined under paragraph 63 has expired.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 10 lakhs as on 1-4-2003. The item was acquired for Rs. 10 lakhs on April 1, 1990 and was available for use from that date. The enterprise has been following an accounting policy of not amortising the item. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years from the date when the item was available for use i.e., April 1, 1990.

Since the amortisation period determined by applying paragraph 63 has already expired as on 1-4-2003, the carrying amount of the intangible item of Rs. 10 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1-4-2003.

Example 2 - Intangible Item is being amortised and the amortisation period determined under paragraph 63 has expired.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 8 lakhs as on 1-4-2003. The item was acquired for Rs. 20 lakhs on April 1, 1991 and was available for use from that date. The enterprise has been following a policy of amortising the item over a period of 20 years on straight-line basis. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years from the date when the item was available for use i.e., April 1, 1991.

Since the amortisation period determined by applying paragraph 63 has already expired as on 1-4-2003, the carrying amount of Rs. 8 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1-4-2003.

Example 3 - Amortisation period determined under paragraph 63 has not expired and the remaining amortisation period as per the accounting policy followed by the enterprise is shorter.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 8 lakhs as on 1-4-2003. The item was acquired for Rs. 20 lakhs on April 1, 2000 and was available for use from that date. The enterprise has been following a policy of amortising the intangible item over a period of 5 years on straight line basis. Applying paragraph 63, the enterprise determines the amortisation period to be 8 years, being the best estimate of its useful life, from the date when the item was available for use i.e., April 1, 2000.

On 1-4-2003, the remaining period of amortisation is 2 years as per the accounting policy followed by the enterprise which is shorter as compared to the balance of amortisation period determined by applying paragraph 63, i.e., 5 years. Accordingly, the enterprise would be required to amortise the intangible item over the remaining 2 years as per the accounting policy followed by the enterprise.

Example 4 - Amortisation period determined under paragraph 63 has not expired and the remaining amortisation period as per the accounting policy followed by the enterprise is longer.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 18 lakhs as on 1-4-2003. The item was acquired for Rs. 24 lakhs on April 1, 2000 and was available for use from that date. The enterprise has been following a policy of amortising the intangible item over a period of 12 years on straight-line basis. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years on straight line basis from the date when the item was available for use i.e., April 1, 2000.

On 1-4-2003, the remaining period of amortisation is 9 years as per the accounting policy followed by the enterprise which is longer as compared to the balance of period stipulated in paragraph 63, i.e., 7 years. Accordingly, the enterprise would be required to restate the carrying amount of intangible item on 1-4-2003 at Rs. 16.8 lakhs (Rs. 24 lakhs -
3xRs. 2.4 lakhs, i.e., amortisation that would have been charged as per the Standard) and the difference of Rs. 1.2 lakhs (Rs. 18 lakhs-Rs. 16.8 lakhs) would be required to be adjusted against the opening balance of the revenue

reserves. The carrying amount of Rs. 16.8 lakhs would be amortised over 7 years which is the balance of the amortisation period as per paragraph 63.

Example 5 - Intangible Item is not amortised and amortisation period determined under paragraph 63 has not expired.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 20 lakhs as on 1-4-2003. The item was acquired for Rs. 20 lakhs on April 1, 2000 and was available for use from that date. The enterprise has been following an accounting policy of not amortising the item. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years on straight line basis from the date when the item was available for use i.e., April 1, 2000.

On 1-4-2003, the enterprise would be required to restate the carrying amount of intangible item at Rs. 14 lakhs (Rs. 20 lakhs - 3xRs. 2 lakhs, i.e., amortisation that would have been charged as per the Standard) and the difference of Rs. 6 lakhs (Rs. 20 lakhs-Rs. 14 lakhs) would be required to be adjusted against the opening balance of the revenue reserves. The carrying amount of Rs. 14 lakhs would be amortised over 7 years which is the balance of the amortisation period as per paragraph 63.